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STATE PASS TO FED BOARD OF GOVERNORS FOR ROBITAILLE

E.O. 12958: N/A

TAGS: [ECON](#) [PGOV](#) [EFIN](#) [PREL](#) [BR](#) [CU](#)

SUBJECT: BRAZIL - FINANCE MINISTER PALOCCI ON SOMEWHAT
FIRMER GROUND

REF: A) Brasilia 3043
B) Brasilia 3008
C) Brasilia 3051

1. (SBU) Summary: After another marathon session in front of one of Congress' economic oversight committees, Finance Minister Antonio Palocci appears to have solidified his political position, allowing him some temporary respite from the political and scandal-related crossfire he has been receiving recently (reftels). Meanwhile, in a face-saving compromise with opposition members of Congress, Palocci agreed to appear voluntarily, instead of pursuant to a formal subpoena, before the Congressional Investigatory Committee (CPI) on bingos, where he would face questioning regarding allegations of corruption during his tenure as mayor of Riberao Preto and his role, as Lula's campaign coordinator, in alleged campaign contributions from Cuban government. Separately, Palocci had a heart-to-heart with President Lula and, reportedly, persuaded the President to back a small increase in the primary surplus target for the year (to about 4.5% to 4.6% of GDP). Lula subsequently declared Palocci's position to be "more solid than ever." While Lula's statement undoubtedly shores up Palocci in his fiscal policy battle with Lula chief of staff Dilma Rousseff, any new revelations of alleged corruption and campaign financing irregularities would further undermine him. End Summary.

2. (SBU) During his second appearance before Congress in recent days (ref A), this time before the Chamber of Deputies Finance and Tax Committee, Finance Minister Palocci put in a solid performance defending the GoB's orthodox economic policy line. As in his appearance before the Senate Economic Affairs Committee, Palocci did not face questions about allegations that he was involved in corruption during his tenure as mayor of Riberao Preto or about his role, as Lula's campaign coordinator, in alleged illegal campaign contributions from the Cuban government to the 2002 presidential campaign. Palocci, however, did face extensive questioning about his recent public disagreement with Lula's chief of staff, Dilma Rousseff, over fiscal policy. While acknowledging a debate within the Lula administration on the point, Palocci was firm, responding that any increase in public investment had to be financed with cuts in current expenditures, and not a reduction in the primary surplus.

3. (SBU) Palocci appears to have made some progress in dealing with the friendly fire on fiscal policy from Rousseff. Palocci met with Lula and reportedly reached a compromise that the Finance Ministry would pursue a primary surplus target in the 4.5% to 4.6% of GDP range, above the current 4.25% target but well below the 6.1% of GDP surplus that the GoB ran during the first nine months of the year. Palocci argued that a higher surplus was necessary since the Central Bank's monetary tightening earlier this year had increased interest outlays on GoB debt. (Comment. Given the difficulties the GoB perennially encounters in trying to spend appropriated monies, it easily be that primary surplus ends up being higher than the agreed to 4.6% target. End Comment.)

4. (U) Separately, the GoB and the opposition reached a compromise that allows Palocci to appear voluntarily before the CPI on bingos to face questions about several sets of allegations made against him (ref B), instead of being formally subpoenaed. The allegations in question include accusations that, as Lula's 2002 campaign coordinator, he allowed an illegal USD 3 million Cuban government campaign contribution to enter the party coffers. Several other sets of allegations center on alleged corruption when he was mayor of the city of Riberao Preto, in Sao Paulo state. While agreeing to Palocci's voluntary appearance, the opposition reportedly insisted that Palocci will be required to sign a statement acknowledging that his testimony before the committee can be used against him in court should he ever face formal charges. A date for the testimony has not

been set.

15. (SBU) Comment: Over the last twenty four hours, Palocci has pulled off quite a balancing act, solidifying his political position and winning himself time. The compromise on the increase in the primary surplus target should lay the foundation for a more coherent public line from the Lula administration on its fiscal intentions. Lula's more enthusiastic public embrace of Palocci in remarks on both November 21 and 22 undoubtedly will help the Minister as well. While Palocci has displayed considerable survival skills, he has yet to face questioning over the various sets of allegations of corruption and campaign-finance irregularities. These may ultimately prove more dangerous to his political survival than the ongoing fiscal policy battles.

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